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BEFORE THE ARIZONA CORPORATION COMMISSION 4:04

WILLIAM A. MUNDELL
Chairman
JIM IRVIN
Commissioner
MARC SPITZER
Commissioner

Arizona Corporation Commission

DOCKETED

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AZ CORP COMMISSION
DOCUMENT CONTROL

IN THE MATTER OF THE APPLICATION
OF U S WEST COMMUNICATIONS, INC.,
A COLORADO CORPORATION, FOR A
HEARING TO DETERMINE THE EARNINGS
OF THE COMPANY, THE FAIR VALUE OF
THE COMPANY FOR RATEMAKING
PURPOSES, TO FIX A JUST AND
REASONABLE RATE OF RETURN THEREON
AND TO APPROVE RATE SCHEDULES
DESIGNED TO DEVELOP SUCH RETURN.

DOCKET NO. T-01051B-99-0105

EXECUTIVE SUMMARY OF
EXCEPTIONS TO PROPOSED ORDER

The Proposed Order properly recommends the approval of the
Settlement Agreement and Price Cap Plan entered into between
Staff and Qwest and supported by the Communications Workers of
America, Department of Defense and the Arizona Payphone
Association. The Price Cap Plan represents a significant step
forward in adapting regulation in Arizona to the changing nature
of the telecommunications industry in this state, by establishing
separate pricing regimes for basic, essential services (Basket 1)
and for nonessential, competitive services (Basket 3). The
Proposed Order, however, makes several changes in the Price Cap
Plan. One of those changes requires Qwest to comply with the

1 criteria and procedures of R14-2-1108 (Rule 1108) when it
2 packages one or more basic services with nonessential services
3 rather than the 30 day review process for implementation of new
4 services or packages of nonessential services. This change will
5 deprive Arizona consumers of many of the most important benefits
6 they would otherwise receive from implementation of the Price Cap
7 Plan. It also represents a change in how such services are
8 currently handled that will reduce Qwest's existing pricing
9 flexibility.
10

11 Arizona consumers increasingly demand more varied and more
12 complex telecommunications services in the form of packages of
13 services tailored to meet their individual needs. While some
14 customers may still want only basic telephone service, many other
15 customers are seeking ways to add value to their
16 telecommunications services by purchasing basic service, vertical
17 features, long distance and other services in competitively
18 priced packages. The Proposed Order unfairly and unreasonably
19 restricts Qwest's ability to provide those packages to Arizona
20 consumers.
21

22 Qwest is currently able to file packages of basic services
23 and nonessential services in a single package that is not
24 submitted for review under Rule 1108. Rather, these packages are
25 reviewed as any other tariff filing. Qwest's competitors have
26

1 the ability to submit packages of basic services and nonessential
2 services without complying with Rule 1108 but simply as 30 day
3 tariff filings. The Proposed Order would remove flexibility that
4 Qwest currently has to package services and would unfairly
5 disadvantage Qwest and its customers as compared to the CLECs and
6 their customers.
7

8 Further, the restriction on packaging contained in the
9 Proposed Order is inconsistent with the trend throughout the
10 United States to permit packaging of basic and nonessential
11 services in a single package with the sort of pricing flexibility
12 provided in the Price Cap Plan. Nineteen of the 42 states, or
13 45%, about which Qwest has information, have adopted a form of
14 price regulation that permits the same or a greater degree of
15 bundling flexibility than is contained in the Price Cap Plan. If
16 the restriction contained in the Proposed Order is adopted, it
17 will represent a backward step rather than a forward step in
18 matching regulation in Arizona with an increasingly competitive
19 telecommunications market.
20

21 The restriction on packaging is unnecessary to protect
22 consumers or competitors. Consumers are protected from being
23 required to buy unwanted packages by the provision of the Price
24 Cap Plan that requires that all basic services be available on a
25 stand-alone basis. Competitors are protected by the requirements
26

1 of the Price Cap Plan that require Qwest to comply with existing
2 imputation and price floor provisions of this Commission's rules.

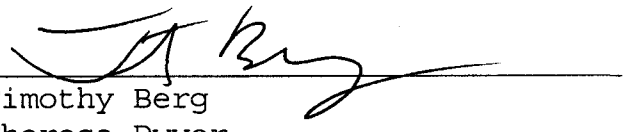
3 If consumers are to have the widest possible choice of
4 options and the ability to obtain the greatest possible value,
5 Qwest must be able to offer packages of basic and nonessential
6 services to consumers in a timely fashion. The Price Cap Plan as
7 filed with the Commission would have permitted Qwest to offer
8 packages including basic services by complying with the same
9 thirty-day notice requirement that currently applies to both
10 Qwest and its competitors. The Proposed Order instead requires
11 Qwest to file under R14-2-1108 for any package containing a basic
12 service and permits Staff six months (with possible additional
13 extensions) to review the filing. This change will prevent
14 Arizona consumers from receiving the packages of services that
15 they desire in a timely fashion and, in effect, means that for
16 the three year term of the Price Cap Plan few, if any, such
17 packages will be available from Qwest.

18 In order to ensure the benefits of the new competitive
19 telecommunications markets for Arizona consumers, the Commission
20 should reject that portion of the Proposed Order that limits
21 Qwest's ability to provide packages. For the reasons discussed
22 in the Exceptions, it should also reject other specific changes
23 made to the Price Cap Plan by the Proposed Order.
24
25
26

1 RESPECTFULLY SUBMITTED this 12th day of February, 2001.

2 FENNEMORE CRAIG, P.C.

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4 By


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1 BEFORE THE ARIZONA CORPORATION COMMISSION

2
3 WILLIAM A. MUNDELL

4 Chairman

5 JIM IRVIN

6 Commissioner

MARC SPITZER

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7
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DOCKET NO. T-01051B-99-0105

**EXCEPTIONS OF QWEST
CORPORATION**

14 **I. INTRODUCTION**

15 Qwest Corporation ("Qwest"), formerly U S WEST Communications, Inc.,
16 submits the following limited exceptions to the recommended opinion and order
17 filed on February 2, 2001 (the "Proposed Order").

18 The Proposed Order properly recommends the approval of the Settlement
19 Agreement and Price Cap Plan entered into between Staff and Qwest and
20 supported by the Communications Workers of America, Department of Defense
21 and the Arizona Payphone Association. The implementation of the Price Cap Plan
22 represents a significant step forward in adapting regulation in Arizona to the
23 changing nature of the telecommunications industry in this state by establishing
24 separate pricing regimes for essential services (Basket 1) and for nonessential,
25 competitive services (Basket 3). The Proposed Order, however, makes several
26

1 changes in the Price Cap Plan. At least one of those changes, which requires
2 Qwest to comply with the requirements of A.A.C. R14-2-1108 when it combines a
3 Basket 1 service with a Basket 3 service, will deprive consumers of significant
4 benefits they would otherwise receive under the Price Cap Plan.

5 Arizona consumers increasingly demand more varied and more complex
6 telecommunications services in the form of packages of services tailored to meet
7 their individual needs. While some customers may still want only basic telephone
8 service, many other customers are seeking ways to add value to their
9 telecommunications services by purchasing basic service, vertical features, long
10 distance and other services in competitively priced packages. Qwest's
11 competitors are entering the Arizona market successfully by offering such
12 packages.

13 If consumers are to have the widest possible choice of options and the
14 ability to obtain the greatest possible value, Qwest must be able to offer such
15 packages to consumers in a timely fashion. Qwest's competitors are able to offer
16 new services and packages including essential telephone service by a 30-day tariff
17 filing. The Price Cap Plan as filed with the Commission would have permitted
18 Qwest to offer packages including basic services by complying with the same
19 30-day notice. The Proposed Order instead requires Qwest to file under A.A.C.
20 R14-2-1108 for any package containing a basic service and permits Staff six
21 months (with possible additional extensions) to review the filing. This change
22 will prevent Arizona consumers from receiving the packages of services that they
23 desire in a timely fashion and, in effect, means that for the three-year term of the
24 Price Cap Plan, few (if any) such packages will be available from Qwest.

25 In order to ensure the benefits of the new competitive telecommunications
26 markets for Arizona consumers, the Commission should reject that portion of the

1 Proposed Order that limits Qwest's ability to provide packages. For the reasons
2 discussed in the Exceptions set forth below, it should also reject other specific
3 changes made to the Price Cap Plan by the Proposed Order.

4 **II. TREATMENT OF NEW SERVICE PACKAGES**

5 The Price Cap Plan establishes three baskets of services: basic/essential
6 services (Basket 1); wholesale services (Basket 2); and flexibly-priced competitive
7 services (Basket 3). Basket 3 contains services previously classified by the
8 Commission as competitive and/or flexibly priced. [TR III at 432-434] As a
9 result, Basket 3 services may be priced no lower than the applicable price floor
10 and increased to generate no more than an additional \$25.3 million. [Id.] Under
11 the terms of the Price Cap Plan, Qwest may create a new service package by
12 combining both Basket 1 and Basket 3 services, and then offer the new package in
13 Basket 3. [TR III at 534]

14 The Proposed Order alters the terms of the Settlement Agreement and Price
15 Cap Plan as follows:

16 Because competition in many markets is in its infancy, it is
17 reasonable to modify the Settlement Agreement and Price Cap Plan
18 to provide that if Qwest desires to combine a Basket 1 service with a
19 Basket 3 service and to include the package in Basket 3, Qwest must
20 comply with A.A.C. R14-2-1108.

21 Proposed Order, Finding of Fact No. 33. In effect, the Proposed Order
22 recommends that a new product offering that includes a Basket 1 service be
23 subject to the criteria and procedures of A.A.C. R14-2-1108, rather than following
24 the 30-day review process for new services or packages of Basket 3 services. The
25 Proposed Order restricts Qwest's pricing flexibility even further than what exists
26 today. It ignores the protections contained in the Settlement Agreement and Price
Cap Plan that protect both consumers and competitors from any abuse of such

1 Proposed Order that limits Qwest's ability to provide packages. For the reasons
2 discussed in the Exceptions set forth below, it should also reject other specific
3 changes made to the Price Cap Plan by the Proposed Order.

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13 Basket 3. [TR III at 534]

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24 the 30-day review process for new services or packages of Basket 3 services. The
25 Proposed Order restricts Qwest's pricing flexibility even further than what exists
26 today. It ignores the protections contained in the Settlement Agreement and Price
Cap Plan that protect both consumers and competitors from any abuse of such

1 packaged service offerings. If adopted, Finding of Fact No. 33 will harm
2 consumers demanding such service packages and discriminate unfairly in favor of
3 competitors who already have such pricing flexibility.

4 The Settlement Agreement and Price Cap Plan protect both consumers and
5 competitors by placing significant pricing constraints on Qwest relative to any
6 Basket 3 offering. The Settlement Agreement requires Qwest's continued
7 compliance with applicable Arizona imputation and price floor rules. [TR II at
8 237; TR III at 543] Under the Price Cap Plan, Qwest cannot price any such
9 package below cost and cross-subsidize any competitive service by
10 non-competitive services. Competitors are further protected against any potential
11 predatory package pricing because Qwest must submit such offerings to the
12 Commission for review 30 days prior to the effective date. [Attachment A to
13 Settlement Agreement, § § 4 (a) and (e); Rebuttal Testimony of David L. Teitzel,
14 November 20, 2000, at 24] Under the terms of the Proposed Order, competitors
15 are provided notice of such offerings, and therefore will have the ability to make
16 their views known during the Commission's review process. Proposed Order,
17 Finding of Fact Nos. 30, 31 and 32.

18 The Proposed Order ignores the fact that even today, Qwest may combine
19 basic and competitive services in a single package but need not submit the
20 offering for A.A.C. R14-2-1108 review. For example, on May 30, 2000, Qwest
21 sought Commission approval to offer a new "Minutes Free" toll calling plan for its
22 business customers. See Exhibit A (Correspondence to Chairman Carl J. Kunasek
23 from Maureen Arnold dated May 30, 2000). Under the proposed offering,
24 business customers would have the option to purchase the combination of a Basket
25 1 service (CUSTOMCHOICE) with a Basket 3 service (intraLATA toll). Id. The
26 Commission approved this tariff filing within 30 days. See In the Matter of the

1 Tariff Filing of U S WEST Communications, Inc. to Introduce a New Minutes
2 Free Toll Calling Plan for Business Customers, Docket No. T-01051B-00-0368,
3 Decision No. 62714 (June 30, 2000). Submission of the offering through the
4 A.A.C. R14-2-1108 process was not required. Id.

5 Qwest's competitors may also introduce new services to Arizona
6 consumers, including basic essential services that are automatically classified as
7 "competitive," and are not required to comply with A.A.C. R14-2-1108. Instead,
8 competitive local exchange carriers file such packaged offerings pursuant to
9 A.R.S. § 40-250—the exact method employed by the Price Cap Plan. As a result,
10 these competitors currently offer combinations of Basket 1 and Basket 3 services
11 as special packages to Arizona customers. For example, Cox now offers local
12 service at discounted rates for customers who also purchase either cable or internet
13 access. See Exhibit B (Cox Website, February 8, 2001—
14 <http://www.cox.com/Phoenix/Telephone/features.asp>). AT&T advertises an "All
15 in One" package for small businesses that includes both local and long distance
16 services. See Exhibit C (AT&T Website, February 8, 2001—
17 http://small.bus.att.com/small_business/services/att_sbs.jhtml?pl=all_in_one).
18 Local service includes voice mail and custom calling features, while the rate for
19 long distance is reduced. Id.

20 The current trend throughout the United States supports permitting the
21 combination of basic services (Basket 1) with non-essential services (Basket 3)
22 together in a single package under flexible arrangements, such as that contained in
23 the Price Cap Plan. Nineteen out of the 42 states or 45%, about which Qwest has
24 information, permit the same or a greater degree of flexibility to package basic and
25 nonessential services than Qwest has under the Price Cap Plan. Qwest now has
26 the ability to flexibly price packages consisting of 1FR/1FB services and vertical

1 features in Minnesota and Nebraska. In South Dakota, Qwest may also package
2 services in this fashion as a competitive response pursuant to statutory authority.
3 Finally, Qwest services provided to customers with more than five access lines are
4 fully deregulated in Idaho. An additional 15 states outside of Qwest's service
5 territory, Alabama, California, Florida, Georgia, Indiana, Louisiana, Michigan,
6 Mississippi, New York, Oklahoma, Rhode Island, South Carolina, Tennessee,
7 Texas and West Virginia, allow packaging flexibility for other Regional Bell
8 Operating Companies commensurate with or greater than the Price Cap Plan.

9 More importantly, the Settlement Agreement requires that any Basket 1
10 service included in a new service package remain available to consumers on a
11 stand-alone basis. Whenever Qwest offers a Basket 1 service as part of a Basket 3
12 "package," Qwest *must* advise its customers that the "basic essential" service
13 remains available on a stand-alone basis at the Basket 1 price. [Rebuttal
14 Testimony of David L. Teitzel, November 20, 2000, at 14-15] Consequently,
15 consumers are guaranteed a choice and may continue to purchase many essential
16 services at prices that were originally set in 1995 and will remain capped for three
17 more years. Id.

18 In fact, Staff's own expert, Harry M. Shooshan III, testified concerning the
19 introduction of new service packages outside the 1108 process and the policy
20 reasons supporting same. Shooshan explained that more restrictive regulation was
21 unnecessary given the considerable protections already contained in the Price Cap
22 Plan, e.g., new service packages remain subject to imputation or TSLRIC,
23 Basket 1 services remain available on a stand-alone basis, etc.:

24 As new services, they still have to meet the imputation rules, the
25 competitive pricing constraints. So there has to be – those showings
26 have to be made. If they do, then there's no reason to me why it
would be inappropriate to have them offered in Basket 3. In fact,

1 that's where we are encouraging – how we are encouraging Qwest,
2 for example, to be innovative, to come up with new applications and
3 new services.

4 In fact, that's where, under this plan, they will be given the
5 opportunity to win back some of the revenue, in effect, that's being
6 lost through these phased reductions in access. Not as they would
7 have had it initially by raising basic exchange rates, which they
8 cannot do during the life of this plan.

9 [TR III at 628] Shooshan noted that competition of this very kind is required, and
10 only benefits consumers who need and demand such services. [TR III at 601, 604-
11 605] Shooshan cautioned against the very modification recommended by the
12 Proposed Order, noting that "competition" simply permits competitors to be
13 present and achieve market position; it does not ensure their continued health.
14 [TR III at 604, 606] ("[T]his plan protects competition—and I stress competition,
15 not necessarily individual competitors. . .").

16 The Commission should note that customers today need and demand the
17 immediate provision of the very service packages contemplated by the Settlement
18 Agreement and the Price Cap Plan. Significant trend indicators support the
19 importance of a single provider, one-stop customer service, and multi-product
20 discounting among residential and small business customers. CLECs have long
21 used this bundled service approach to gain revenue and customer base advantages
22 in the marketplace. See Exhibit D ("CLECs Go the Distance," Gary Kim,
23 X-Change, 10/1998). The A.A.C. R14-2-1108 process contemplated by the
24 Proposed Order requires a protracted review before even reaching the Commission
25 for decision. In effect, this protracted process is no longer necessary. As
26 discussed above, the Proposed Order would result in a step backwards from the
current environment where Qwest may introduce similar packages under the
30-day review set forth in A.R.S. § 40-250. Further, Finding of Fact No. 33

1 would require a separate filing under A.A.C. R14-2-1108 for each individual
2 package, even if the packages were materially the same. For example, if Qwest
3 wanted to offer a new package that combined CUSTOMCHOICE with 200
4 minutes of toll, the Proposed Order would require Qwest to file for approval under
5 A.A.C. R14-2-1108 even though the Commission has already approved the
6 comparable "Minutes Free" plan (i.e., CUSTOMCHOICE with 100 toll minutes).
7 The effect not only delays the benefits of the new package to customers, but
8 needlessly increases the administrative burdens for both the Commission and
9 Qwest. In effect, such a prolonged process is no longer necessary. It will simply
10 prevent any meaningful competition by limiting available choices to the
11 disadvantage of consumers.

12 The Proposed Order claims such delays are necessary because competition
13 is in its "infancy." Qwest respectfully disagrees. This Commission first adopted
14 rules that mandated competition in the local exchange markets and in the
15 intraLATA toll market in June 1995. [TR I at 35-37] Congress passed the
16 Telecommunications Act of 1996 (the "Act") shortly thereafter. [Id.] In 1996, the
17 Commission heard and concluded a series of arbitrations under the Act and since
18 that time has heard and approved hundreds of interconnection and resale
19 agreements. [Id.] Additionally, the Commission has issued numerous certificates
20 of convenience and necessity to carriers allowing for the provisions of competitive
21 intraLATA toll service, competitive local exchange service, resold toll service,
22 and resold local exchange services. [Id.] Qwest's Section 271 docket has been
23 under analysis and review by this Commission for the past two years. [Id.] In
24 actuality, Qwest already faces significant competition in Arizona. In some
25 instances, competition exists on a geographic basis, as in the case of the Phoenix
26 and Tucson business corridors where CLECs can duplicate any Qwest service.

1 Other services, such as toll and directory assistance, have been designated by the
2 Commission as fully competitive on a statewide basis. Given the foregoing, the
3 Proposed Order's characterization of the status of competition in Arizona as
4 "newborn" is incorrect and does not provide a reasonable basis for imposing more
5 severe regulatory restrictions on Qwest that do nothing to advance meaningful
6 competition in this state. Under these circumstances, "it is unclear [to me] how
7 placing additional pricing constraints on Qwest beyond those that exist today will
8 advance competition." [Harry M. Shooshan III, Rebuttal Testimony Regarding
9 Settlement Agreement, November 20, 2000, at 4]

10 Finding of Fact No. 33 does nothing but prevent Qwest from delivering
11 necessary services and service packages to Arizona consumers. It retards rather
12 than advances competition and is more restrictive than current Commission
13 methods. This additional restriction is unnecessary in light of the safeguards for
14 both consumers and competitors already contained in the Settlement Agreement
15 and Price Cap Plan. It is in the public interest for the Commission to reject
16 Finding of Fact No. 33 of the Proposed Order. Accordingly, the Commission
17 should delete Finding of Fact No. 33 and any references thereto in the Proposed
18 Order (specifically at Page 15, Lines 7-10; Page 25, Lines 2-5; and Page 25, Line
19 23).

20 **III. GEOGRAPHIC PRICING**

21 The Proposed Order erroneously concludes that Section 4) g) of the Price
22 Cap Plan is vague and ambiguous and should be removed from the Price Cap
23 Plan. Proposed Order, Finding of Fact No. 34. Section 4) g) of the Price Cap Plan
24 permits Qwest to price services and packages of services contained in Basket 3 to
25 selected customer groups based on factors such as their purchasing patterns and
26 geographic location. The Proposed Order rejects this provision because the terms

1 describing when, where and to whom such services may be offered are not
2 precisely defined. If the terms are not sufficiently defined, the Proposed Order
3 concludes that a conflict may exist between Section 4) g) and A.R.S. § 40-334.

4 The Proposed Order ignores the express provisions of the Price Cap Plan
5 which prohibit discrimination and ensure that competition will not be barred.
6 A.R.S. § 40-334 prohibits any unreasonable difference as to rates, charges,
7 facilities or in any other respect, either between localities or between classes of
8 service. The prohibitions contained in Section 40-334 are expressly incorporated
9 into Section 4) g) of the Price Cap Plan. Qwest has also expressed its commitment
10 to comply with Section 40-334. [TR II at 236] Furthermore, all offerings under
11 section 4) g) must be submitted to the Commission at least 30 days in advance of
12 their going into effect, thereby giving the Commission the opportunity to deny any
13 classification or pricing that would violate Section 40-334. [TR II at 635]

14 The law clearly prohibits discrimination by Qwest, Qwest has committed
15 not to discriminate, and the Commission has the opportunity to deny any
16 classification or pricing that would result in discrimination. There can be no
17 stronger statement against discrimination. Yet, without any discussion of how
18 discrimination will occur, the Recommended Order concludes that the ability to
19 engage in geographic pricing conflicts with Section 40-334. The express ban on
20 discrimination and the Commission's ability to deny any discriminatory pricing
21 before it is implemented mandate that a different conclusion be reached in the
22 Commission's Order.

23 The Price Cap Plan also protects against anti-competitive behavior. The
24 Proposed Order discusses the CLECs' argument that under Section 4) g), Qwest
25 would have the ability to spot price in order to preclude competition in particular
26 areas. Additionally, the CLECs asserted that Qwest could subsidize low rates in

1 selected areas by charging higher prices for the services in areas with no
2 competition. The Proposed Order, however, fails to discuss the portions of the
3 Price Cap Plan that ensure that the CLECs' concerns will not be realized.

4 Under section 4) f) of the Price Cap Plan, all services and packages in
5 Basket 3 must be priced above their respective TSLRIC cost unless a different
6 cost standard applicable to all telecommunications service providers is determined
7 appropriate by the Commission. Further, the individual services and packages
8 must comply with the imputation requirements of A.A.C. R14-2-1310. TSLRIC
9 cost is the appropriate measure of cross subsidy such that if the service is priced
10 above its respective TSLRIC cost, it is not being subsidized. [TR II at 236]
11 Additionally, A.A.C. R14-2-1310 requires the imputation of the price of all
12 essential elements and the TSLRIC cost of all nonessential elements into the retail
13 price floor. [TR II at 237] Therefore, under the Price Cap Plan, Qwest may not
14 engage in anti-competitive pricing.

15 Lastly, the terms used in Section 4) g) are not vague and ambiguous as
16 suggested in the Proposed Order. Staff witness, Harry M. Shooshan, explained
17 what is permitted under Section 4) g). By allowing Qwest to offer services based
18 on purchasing patterns, Qwest is permitted to tailor new services and packages to
19 certain types of customers. [TR III at 659] Qwest is simply being afforded the
20 same flexibility as the CLECs. [Id.] The clear and concise language of
21 Section 4) g) provides Qwest the ability and incentive to offer, without delay, a
22 variety of new services and packages that will meet the needs of its customers.

23 The Price Cap Plan, considered in its entirety, ensures that the concerns
24 raised by the CLECs and acknowledged in the Proposed Order will not come to
25 fruition. Section 4) g) specifically prohibits price discrimination against any class
26 of customer. Furthermore, Qwest may not engage in anti-competitive behavior.

1 Therefore, the Proposed Order should be modified to delete Finding of Fact No.
2 34. Additionally, Page 19, Lines 11-22, should be replaced with a discussion
3 consistent with the points set forth above.

4 If, after considering the foregoing, the Commission believes that
5 Section 4) g) is still problematic, Qwest believes that the provision can be
6 modified to address the stated concerns. The Commission may modify the first
7 sentence of Section 4) g) as follows: "New services and packages in Basket 3 may
8 be offered to selected customer groups based on geographic location, at such time
9 as the Commission orders wholesale geographic rate de-averaging, consistent with
10 that de-averaging." Under the Price Cap Plan, Qwest would be afforded the
11 opportunity to geographically de-average retail services and packages in Basket 3.
12 If the Commission believes that such de-averaging is not appropriate without
13 further definition, the proposed alternative language would instead restate Qwest's
14 ability to geographically de-average retail rates consistent with any future
15 de-averaging of wholesale services. See Decision No. 60635 at 22 (geographic
16 de-averaging should occur for retail customers at the same time it occurs at the
17 wholesale level).

18 **IV. TECHNICAL CORRECTIONS**

19 **A. Clarification of Services as Competitive**

20 On Page 5, Lines 4 and 5, the Proposed Order incorrectly states that the
21 revenue requirement deficiency would be recovered through "1) a combination of
22 increases and decreases in rates for services in Basket 1." Likewise, on Page 9,
23 Lines 12 and 13, the Proposed Order erroneously states that "\$17.6 million will be
24 derived from an increase in some basic non-competitive services, primarily from
25 directory assistance rates and rates for private line services." These statements
26 incorrectly state that the initial \$17.6 million increase will come from

1 non-competitive services. Although the Proposed Order correctly states that the
2 \$17.6 million increase will come primarily from directory assistance rates and
3 rates for private line services, the order should be revised to reflect that these
4 services have been classified as competitive. See e.g., In the Matter of U S WEST
5 Communications, Inc.—Petition to Have Certain IntraLATA Toll Services
6 Competitive and to Change Certain Message Telecommunications Rates, Docket
7 No. E-1051-96-160, Decision No. 59637 (April 24, 1996); In the Matter of the
8 Application of U S WEST Communications, Inc. for Competitive Classification of
9 Directory Assistance Service, Docket No. T-01051B-99-0362, Decision No.
10 62129 (December 14, 1999). Therefore, Page 5, Lines 4 and 5 should be revised
11 to read: “1) a combination of increases in rates for services in Basket 3 and
12 decreases in rates for services in Basket 1 amounting to a net increase of \$17.6
13 million.” Additionally, Page 9, Lines 12 and 13, should be revised as follows:
14 “\$17.6 million will be derived from an increase in some basic competitive
15 services, primarily from directory assistance rates and rates for private line
16 services.”

17 B. Public Access Line Rates

18 The Proposed Order neglects to include a finding approving the public
19 access line rates agreed to by Qwest and the Arizona Payphone Association
20 (“APA”). Qwest and the APA reached an agreement, contingent upon the
21 Commission approving the Settlement Agreement, as to the public access line
22 rates that Qwest charges customers in Arizona. [Testimony of Gary Joseph at 2;
23 TR III at 519] There have been no objections to the agreement reached by Qwest
24 and the APA, therefore, a finding should be included approving the rates as agreed
25 upon. The Proposed Order should be modified accordingly: (1) Finding of Fact
26 No. 20 revised to read “On November 28, 2000, the American Payphone

1 Association filed testimony in support of the Settlement Agreement and setting
2 forth the public access lines rates for the time of the initial term of the Rate
3 Proceeding Moratorium Period agreed to by Qwest and the APA, contingent upon
4 the approval of the Settlement Agreement. A copy of testimony is attached
5 hereto.” (2) add a Conclusion of Law that finds that “The public access lines rates
6 set forth in the American Payphone Association’s November 28, 2000 testimony
7 are just and reasonable and should be approved.” and (3) the Commission should
8 order “IT IS THEREFORE ORDERED that the public access lines rates set forth
9 in the American Payphone Association’s November 28, 2000 testimony are
10 hereby approved.”

11 C. Price Floors for Basket 3 Services

12 Section 4) e) of the Price Cap Plan requires that the price of a new package
13 or service exceed the TSLRIC of the package or service and comply with the
14 imputation requirements of A.A.C. R14-2-1310(C). The Proposed Order
15 concludes that Rule 1310 is ambiguous and, therefore, orders that Staff open a
16 docket to investigate and rectify possible ambiguities involving the pricing of
17 telecommunication services and imputation in particular. Further, the Proposed
18 Order states that until the Commission clarifies Rule 1310, the Settlement
19 Agreement shall be interpreted as requiring that originating access be considered
20 an essential component of retail toll service.

21 Qwest believes the interpretation of Rule 1310 set forth in the Proposed
22 Order is erroneous and Qwest’s existing toll packages are not priced below the
23 imputation floor set in the rule. However, the correct imputation standard to be
24 included in Rule 1103 must be determined as a result of the docket arising from
25 Staff’s investigation into and clarification of that rule.

26 Implementation of the interim interpretation of Rule 1310 set forth in the

1 Proposed Order would impact present customers on Qwest's Business Super
2 Savings Plan adversely because Qwest would be required to switch these
3 customers to a different package or increase the price of the existing plan. If the
4 Commission later concluded that Qwest's understanding of Rule 1103 is correct,
5 the customers would face either another rate change or another change of toll plan.

6 The Commission's concerns may be addressed without creating customer
7 confusion and inconvenience by grand-fathering the existing Business Super
8 Savings Plan customers until the Commission addresses the imputation rule in the
9 new docket. This would allow Qwest's 3,400 customers on the plan to continue to
10 benefit from the package without the bother of consecutive changes in their
11 service. Therefore, Page 17, Lines 14 and 15 should be revised as follows: "In the
12 meantime, until the Commission has made a final determination regarding Rule
13 1310, for purposes of this Settlement Agreement, Qwest may continue to provide
14 the Business Super Savings Plan to those customers currently subscribing to the
15 plan."

16 **V. CONCLUSION**


17 Based on the evidence presented at hearing, and the foregoing, Qwest
18 requests that the Commission adopt the Proposed Order with the following
19 modifications:

- 20 • Delete Finding of Fact No. 33 and any references thereto in the
21 Proposed Order, i.e., Page 15 (Lines 7-10); Page 25 (Lines 2-5); and
22 Page 25 (Line 23);
- 23 • Delete Finding of Fact No. 34 and any references thereto in the
24 Proposed Order, i.e., Page 19 (Lines 11-22);

- 1 • Revise Page 5 (Lines 4 and 5) as follows: “1) a combination of
2 increases in rates for services in Basket 3 and decreases in rates for
3 services in Basket 1 amounting to a net increase of \$17.6 million;”
4 and
- 5 • Revise Page 9 (Lines 12 and 13) as follows: “\$17.6 million will be
6 derived from an increase in some basic competitive services,
7 primarily from directory assistance rates and rates for private line
8 services.”
- 9 • Revise Finding of Fact No. 20 to read “On November 28, 2000, the
10 American Payphone Association filed testimony in support of the
11 Settlement Agreement and setting forth the public access lines rates
12 for the time of the initial term of the Rate Proceeding Moratorium
13 Period agreed to by Qwest and the APA, contingent upon the
14 approval of the Settlement Agreement. A copy of testimony is
15 attached hereto.”
- 16 • Add a Conclusion of Law finding that “The public access lines rates
17 set forth in the American Payphone Association’s November 28,
18 2000 testimony are just and reasonable and should be approved.”
- 19 • Add a Commission order “IT IS THEREFORE ORDERED that the
20 public access lines rates set forth in the American Payphone
21 Association’s November 28, 2000 testimony are hereby approved.”
- 22 • Revise Page 17 (Lines 14 and 15) as follows: “In the meantime, until
23 the Commission has made a final determination regarding Rule 1310,
24 for purposes of this Settlement Agreement, Qwest may continue to
25 provide the Business Super Savings Plan to those customers currently
26 subscribing to the plan.”

1 RESPECTFULLY SUBMITTED this 12th day of February, 2001.

2 FENNEMORE CRAIG, P.C.

3
4 By 
5 Timothy Berg
6 Theresa Dwyer
7 3003 North Central, Suite 2600
8 Phoenix, Arizona 85012
9 Attorneys for Qwest Corporation

10 ORIGINAL AND TEN of the foregoing
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12 February, 2001, with:

13 Docket Control
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16 Phoenix, Arizona 85007

17 COPY of the foregoing hand-delivered
18 this 12th day of February, 2001, to:

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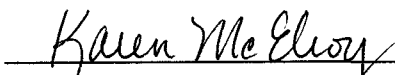
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May 30, 2000

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AZ CORP COMMISSION
DOCUMENT CONTROL

Honorable Carl J. Kunasek - Chairman
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007


Dear Chairman Kunasek:

The attached tariff pages are being filed to introduce a new "Minutes Free" toll calling plan for business customers. "Minutes Free" is an optional plan that will be offered in connection with Centrex 21 service and the Business *CUSTOMCHOICE* package.

Customers who select the Minutes Free plan will receive 100 free minutes of intraLATA toll calling each month. Additional usage beyond the first 100 minutes will be billed at a rate of \$0.09 per minute (\$.045 for the first 30 seconds and \$.009 for each additional 6 second increment). The maximum per minute rate for this plan will be \$0.2994, which is the current maximum rate for business MTS service listed in Section 6.2.1 of the tariff. Although we do not currently plan to assess a monthly or non-recurring charge for the Minutes Free plan, we are requesting that the Commission authorize maximum monthly and non-recurring rates of \$5.00, respectively, in order to accommodate potential future needs of the business.

Please contact Reed Peterson on 602-630-8221 if you have any questions concerning this matter. These pages have been prepared with an effective date of July 10, 2000. We would appreciate your concurrence in this matter.

Sincerely,



cc: Commissioner Jim Irvin
Commissioner William A. Mundell
Ms. Deborah R. Scott - Director, Utilities Division
Legal Division - Arizona Corporation Commission

Issued: 5-30-00

Effective: 7-10-00

6. MESSAGE TELECOMMUNICATION SERVICE

6.3 OPTIONAL SERVICE OFFERINGS (Cont'd)

6.3.18 CALLING CONNECTION PLANS

A. Rates

Minutes Free

USOC	MAXIMUM NON- RECURRING CHARGE	MAXIMUM MONTHLY RATE	MAXIMUM RATE PER MINUTE
OBK5X	\$5.00	\$5.00	[1]

(N)

(N)

Business Daytime Connection Plus

Customers subscribing to this Plan will receive a minimum 30% discount on customer-dialed calling card charges.

USOC	MAXIMUM MONTHLY RATE	MINUTES	MAXIMUM RATE PER MINUTE RATE PERIOD	
			INITIAL (30 SECONDS)	ADDITIONAL (6 SECONDS)
OBK6X	\$10.80	0 - 60 61 and over	- \$0.085	- \$0.017

Arizona Value Calling Plan[2]

(T)

USOC	MAXIMUM MONTHLY RATE	MAXIMUM RATE PER MINUTE RATE PERIOD	
		INITIAL (30 SEC.)	ADD'L. (6 SEC.)
OBW4X	-	\$0.060	\$0.012

[1] See rates for Business MTS Charges in 6.2.1.C.3.

(N)

[2] A minimum 5% discount applies to all dial station-to-station and customer dialed calling card calls placed Monday through Friday from 8:00 a.m. to 5:00 p.m.

(T)

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9. CENTRAL OFFICE SERVICES

9.1 DIAL SWITCHING SYSTEMS

9.1.17 CENTREX 21 SERVICE

A.2. (Cont'd)

FEATURE	ANALOG	DIGITAL VOICE
• Hunting	X	X
• Individual Line Billing	X	X
• Intercept	X	X
• Incoming Calling Identification	-	X
• Message Waiting Service		
- Audible	X	X
- Visual	X	X
• Speed Calling	X	X
• Standard Configuration Group	-	X
• Touch-Tone	X	X

3. Centrex 21 optional features include the following features depending upon the serving central office:

FEATURE	ANALOG	DIGITAL VOICE
• Additional Secondary Directory Number	-	X
• Analog Call Appearance	-	X
• Call Park	X	-
• Caller Identification Name and Number	X	-
• Calling Connection Plan Credit		
- Business Daytime Connection Plus	X	-
- Volume Calling Connection	X	-
- <i>SUPER SAVINGS</i>	X	-
• Calling Connection Plans		
- Minutes Free	X	-
• 2B+D (Circuit Switched Data)	-	X
• Electronic Business Set	X	-
• Nonstandard Configuration Group	-	X
• Remote Access Forwarding	X	-
• Scheduled Call Forwarding	X	-
• Wireless Extension	X	-

(N)
(N)

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5. EXCHANGE SERVICES

5.9 PACKAGED SERVICES

5.9.1 PACKAGES ASSOCIATED WITH BASIC EXCHANGE SERVICE (Cont'd)

E. Business *CUSTOMCHOICE*

1. Description

Business *CUSTOMCHOICE* is a package of features available to one and two line business customers in conjunction with an additional or individual flat rate access line. Business customers subscribing to the package are entitled to unlimited use of the services/features specified below:

- Anonymous Call Rejection
- Call Forwarding
 - Busy Line (Expanded)
 - Busy Line (External)
 - Busy Line (Overflow)
 - Busy Line/Don't Answer (Expanded)
 - Busy Line (External)/Don't Answer
 - Busy Line (Overflow)/Don't Answer
 - Busy Line (Programmable)
 - Don't Answer
 - Don't Answer (Expanded)
 - Don't Answer (Programmable)
 - Variable
- Call Transfer
- Call Waiting
- Call Waiting ID
- Caller ID Name and Number
- Calling Connection Plans[1]
 - Minutes Free
- Continuous Redial
- Custom Ringing
- Hunting
- Last Call Return
- Message Waiting Indication

(N)
(N)

[1] For Terms, Conditions, Rates and Charges see 6.3.18 in the Competitive Exchange and Network Services Administrative Guidelines.

(N)
(N)

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6. MESSAGE TELECOMMUNICATION SERVICE

6.3 OPTIONAL SERVICE OFFERINGS (Cont'd)

6.3.18 CALLING CONNECTION PLANS

A. Description

MTS Calling Connection Plans (hereafter referred to as the Plans) are optional toll calling discount plans. The Plans are defined below.

Minutes Free

Customers must subscribe to Business *CUSTOMCHOICE*[1] or Centrex 21 Service[2] to be eligible for this plan. The monthly rate for Business *CUSTOMCHOICE* or Centrex 21 Service will include a designated number of minutes of intraLATA toll. For all additional plan calls, the customer will be charged a special rate specified in C., following.

Business Daytime Connection Plus

Customers subscribing to this Plan will be charged a monthly rate for which they receive a designated number of minutes of intraLATA toll. For all additional Plan calls, the customer will be charged a special rate specified in C., following. The monthly rate will always apply. In addition, customers will receive a discount on the customer-dialed calling card charge as specified in C., following.

Arizona Value Calling Plan

Customers subscribing to this Plan will be charged a special rate specified in C., following for calls made during a designated time. In cases where standard MTS rates are lower than the special rate, the lower rate applies. This Plan applies only to dial station-to-station and customer-dialed calling card intraLATA calls placed within the customer's billing period during the following hours:

Monday through Friday	5:00 P.M. to 8:00 A.M. the following day -
Saturday	8:00 A.M. to 8:00 A.M. the following day
Sunday	8:00 A.M. to 8:00 A.M. the following day

In addition, customers will receive a discount on all dial station-to-station and calling card calls placed Monday through Friday from 8:00 A.M. to 5:00 P.M. This discount is applied only to the MTS usage portion of the call.

In cases where calls extend beyond the designated hours for the Plan, the normal long distance charges will apply to each additional minute beyond the designated hours. In cases where a normal long distance call extends into the Plan period, the Plan charges will apply to each additional minute within the designated hours.

- [1] For Terms and Conditions see 5.9.1 in the Exchange and Network Services Tariff.
[2] For Terms and Conditions see 9.1.17.

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AZ2000-024

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6. MESSAGE TELECOMMUNICATION SERVICE

6.3 OPTIONAL SERVICE OFFERINGS

6.3.18 CALLING CONNECTION PLANS (Cont'd)

C. Rates

Minutes Free

USOC	MINUTES	RATE PERIOD	
		INITIAL (30 SEC)	ADDNL (6 SEC.)
OBK5X	0 - 100	-	-
	101 and over	\$0.045	\$0.009

(N)

(N)

Business Daytime Connection Plus

Customers subscribing to this Plan will receive a 30% discount on customer-dialed calling card charges.

USOC	MONTHLY RATE	MINUTES	RATE PERIOD	
			INITIAL (30 SECONDS)	ADDITIONAL (6 SECONDS)
OBK6X	\$8.40	0 - 60	-	-
		61 and over	\$0.070	\$0.014

Arizona Value Calling Plan[1]

USOC	MONTHLY RATE	RATE PERIOD	
		INITIAL (30 SECONDS)	ADDITIONAL. (6 SECONDS)
OBW4X	-	\$0.060	\$0.012

[1] A 5% discount applies to all dial station-to-station and customer dialed calling card calls placed Monday through Friday from 8:00 a.m. to 5:00 p.m.

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9. CENTRAL OFFICE SERVICES

9.1 DIAL SWITCHING SYSTEMS

9.1.17 CENTREX 21 SERVICE

A.2. (Cont'd)

FEATURE	ANALOG	DIGITAL VOICE
• Hunting	X	X
• Individual Line Billing	X	X
• Intercept	X	X
• Incoming Calling Identification	-	X
• Message Waiting Service		
- Audible	X	X
- Visual	X	X
• Speed Calling	X	X
• Standard Configuration Group	-	X
• Touch-Tone	X	X

3. Centrex 21 optional features include the following features depending upon the serving central office:

FEATURE	ANALOG	DIGITAL VOICE
• Additional Secondary Directory Number	-	X
• Analog Call Appearance	-	X
• Call Park	X	-
• Caller Identification Name and Number	X	-
• Calling Connection Plan Credit		
- Business Daytime Connection Plus	X	-
- Volume Calling Connection	X	-
- <i>SUPER SAVINGS</i>	X	-
• Calling Connection Plans		
- Minutes Free	X	-
• 2B+D (Circuit Switched Data)	-	X
• Electronic Business Set	X	-
• Nonstandard Configuration Group	-	X
• Remote Access Forwarding	X	-
• Scheduled Call Forwarding	X	-
• Wireless Extension	X	-

(T)

(N)

(N)

NOTICE

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Effective: 7-10-00

9. CENTRAL OFFICE SERVICES

9.1 DIAL SWITCHING SYSTEMS

9.1.17 CENTREX 21 SERVICE

D. Optional Service Feature - Description (Cont'd)

Minutes Free[1]

The monthly rate for Centrex 21 Service will include a designated number of minutes of intraLATA toll. For all additional plan calls, the customer will be charged a special rate specified in 6.3.18.

(N)

(N)

Business Daytime Connection Plus[1]

Customers subscribing to this plan are charged a monthly rate for which they receive a designated number of minutes of intraLATA toll. For all additional calls, customers are charged a special per minute rate specified in rates and charges. The monthly rate will always apply. In addition, customers will receive a discount on the Operator-Assisted Station-to-Station Calling Card charge (0+ only) specified in rates and charges.

Volume Calling Connection[1]

Customers subscribing to this plan are charged a special rate that is not distance sensitive as specified in rates and charges. In addition, customers receive a discount based on the monthly MTS Plan usage billed to their account. The discount applies to the customer's total amount of intraLATA toll billed each month, per account.

SUPER SAVINGS Calling Plan[1]

SUPER SAVINGS Calling Plan customers will be charged a special rate, for their intrastate/intraLATA dial station-to-station long distance calls.

Remote Access Forwarding (Call Following)[2]

Allows all incoming calls to be forwarded to another telephone number. It allows the customer to remotely change the termination of their incoming calls. From any tone signaling telephone, the customer can activate, deactivate, or change the destination number.

(M)

[1] For Terms and Conditions see 6.3.18.

[2] For Terms and Conditions see 5.4.3. of the Exchange and Network Services Tariff.

(M) Material moved to Page 144.12.

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9. CENTRAL OFFICE SERVICES

9.1 DIAL SWITCHING SYSTEMS

9.1.17 CENTREX 21 SERVICE

D. Optional Service Feature - Description (Cont'd)

Wireless Extension[1]

A wireline forwarding service that works with a customer's wireless service. When a call is placed to the wireline number, it is automatically forwarded to a designated wireless number if the handset is turned on. If the wireless handset is turned off or is busy, the call rings at the wireline number and is not forwarded. In addition, any call coming from the designated wireless number to the wireline number will not be forwarded back to the wireless number.

(T)(M)

(M)

Electronic Business Set

Electronic Set Service permits the use of special electronic station sets with Centrex Plus Service. This service utilizes a unique line card to provide communications control for the electronic station set.

The customer-provided electronic set is a touch-tone station that provides programmable keys for features and additional numbers. It is served from the central office by a main or extension station line. It has assignable keys for station line pick-ups or features. Electronic sets and adjunct modules are provided by the customer.

- Multiple Appearance Directory Number (MADN)
 - A directory number assigned to more than one electronic station set.
- Software Numbers
 - Software numbers are numbers which do not require an additional station line. These numbers share the facilities of the primary directory listed number. Variations of software numbers are:
 - Primary Appearance - The first appearance of a software number on a key.
 - Secondary Appearance - The second appearance of a software number on a key. The secondary software number can be on the same station or a different station.
 - Single Appearance - A software number that appears only on one station and one key.

Nonstandard Configuration Group

Allows customers to purchase additional configuration groups (beyond the five standard configuration groups provided) to support ISDN terminals.

[1] For Terms and Conditions see 5.4.3. of the Exchange and Network Services Tariff.

(T-M)

(M) Material moved from Page 144.11.1.

B



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Cox Digital Telephone

Basic Service

First Line	Monthly \$11.75**
Second Line	\$6.50**
Activation Charge	\$10.00***

Basic Features

• *Three - Way Calling	\$2.75
• *Busy Line Redial	\$2.75
• *Speed Calling	\$2.75
• *Call Forwarding	\$2.75
• *Call Forwarding Busy	\$2.75
• *Call Forwarding No Answer	\$2.75
• *Call Forwarding Remote Access	\$2.75
• *Call Return	\$2.75
• *Priority Ring	\$2.75
• *Long Distance Alert	\$2.75
• *Selective Call Acceptance	\$2.75
• *Selective Call Forwarding	\$2.75
• *Selective Call Rejection	\$2.75
• Caller ID - Per Call Blocking	FREE
• Caller ID - Per Line Blocking	FREE
• 900 & 976 Number Blocking	FREE
• Anonymous Call Rejection	FREE

Premium Features

• Call Waiting	\$4.00
• Caller ID	\$5.00
• Call Waiting ID	\$9.00
• Voice Mail	\$4.95
• Voice Mail Box Extensions	\$4.95
• Voice Mail Plus	\$6.95
• Voice Mail Plus Extensions	\$9.90

Cox Packages

*Solutions Package	\$14.95
------------------------------------	---------

Features include: Call Waiting, Call Waiting ID, Call

Digital Cable

Digital Telephone

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Channel Lineups

Whether you are looking for
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or Premium channels, Get
Local, and find out what
channels are available in
your area.

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Forwarding on Call Waiting, Three-Way Calling, Busy Line Redial, Speed Dialing, Call Forwarding, Call Forwarding Busy, Call Forwarding No Answer, Caller ID, Call Return, Selective Call Acceptance, Selective Call Rejection, Selective Call Forwarding, Priority Ringing, Long Distance Alert

Control Plus Package **\$10.95**

Features include: Call Waiting ID (Call Waiting & Caller ID combined), Call Return, Priority Ring and Long Distance Alert.

Active Lifestyle Package **\$ 6.95**

Features include: Call Waiting, Call Forwarding, Three - Way Calling, Speed Calling, Busy Line Re-dial.

Available ONLY to Cox Telephone customers that ALSO have one of the following: COX Cable, Digital Cable or HSD:

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** Pricing reflects Cox preferred rates (for customers who also purchase either cable or Internet access from Cox). Prices do not include taxes or surcharges.

*** New subscribers to Cox Digital Telephone will be charged \$10 on the initial installation of their first line. Activation charges on all additional lines added on the initial service order will be waived for the first time subscribers. Activation charge does not include inside wiring installation or additional jacks. Rates subject to change and limitations may apply. Service not available in all areas.

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C



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- **Toll-Free service at 7.5¢* per minute**
from state-to-state in the U.S. (It's just 6.5¢* per minute for the lines on which you have AT&T Local Service.)
- **Local toll calls**
at flat per-minute rates.
- **Calling Card calls at 9¢ per minute**
interstate within the U.S. with a 60¢ per call charge.
- **Local calling**
including voice mail, call waiting, call forwarding, three-way calling, speed calling, hunting and Caller ID. All through AT&T Local Service.

*AT&T requires a minimum monthly usage of \$9.95 across all services. If your monthly usage falls below this minimum you will be billed the difference. (The minimum usage is the combined sum of all your AT&T services, including Long Distance, Toll-Free, Local Toll and/or Calling Card. If you have AT&T Local Service, the minimum fee is waived.)

Toll-Free fees.

There is a \$5 per month service charge for each toll-free routing arrangement.

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There is a 60¢ surcharge per call. When

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calling from a payphone, a third-party connection fee and surcharge may apply. Rates for international calling vary according to country.

Regulatory:

The FCC has changed the way long distance carriers pay access fees to local phone companies. AT&T recovers some of its per-customer access costs in the form of a monthly Carrier Line Charge of \$3.40 assessed only to multiple-line users. Single-line users will not be assessed this charge.

In addition, the FCC requires AT&T to contribute to the Universal Service Fund. AT&T assesses a Universal Connectivity Charge of 8% on monthly usage to recover this fee and associated administrative expenses.

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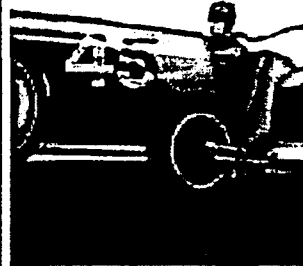
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Posted: 10/1998

CLECs Go the Distance

Additional Services Help Carry the Bundle

By Gary Kim



Though primarily aiming to secure share in the \$98 billion local exchange business, U.S. competitive local exchange carriers (CLECs) have developed a wide range of strategies for securing immediate cash flow, and long distance revenues remain an early favorite.

GST Telecommunications Inc., for example, long has used a strategy of acquiring long distance resellers, in large part to acquire immediate cash flow and customer base, says spokeswoman Lisa Miles.

"It's a fast way to gain customers, and if you're late to market, it gives you a place to start," she says.

Cross-selling of local services into the existing base is but one advantage.

Aside from the tactical advantage of gaining crucial revenue and a customer base, long distance also is a strategic issue for nearly all CLECs. That's because a focus on "all-distance" services stands as the primary positioning taken by most U.S. CLECs.



Image: U.S CLEC Long Distance Revenue, 1997/1998

The reasons are many. For starters, the old distinction between local and long distance carriers is fast disappearing. So there's little sense in structuring their new competitive businesses on outmoded regulatory models. A clearly significant trend among competitive carriers of all types "is the convergence of multiple product offerings and skill sets among individual carriers," says James Henry, telecom analyst for Bear, Stearns & Co. Inc.

"What were once discrete segments of the industry now are being blurred as carriers attempt to develop full-service product portfolios that include local, long distance, data and Internet services," Henry notes. "Companies clearly need to develop full-service portfolios and skill sets in order to optimize the leverage of their network assets and sales channels, and to reduce customer churn."

**Typical Monthly Local Access
Revenue Per Line, \$**

US LEC LLC	68
ICG Communications Inc.	57-60
McLeodUSA	70
e.spire Communications Inc.	50

Source: Company reports and interviews

Another key factor is the type of customer most CLECs are chasing. Smaller and medium-sized businesses, with as few as six or as many as several hundred access lines or desktops, are highly inclined to prefer a single invoice from a single provider for local and long distance service. So it just makes sense to bundle both services with Internet access as a way of prying customers loose from incumbent carriers that typically don't have a direct sales force targeting this customer segment.

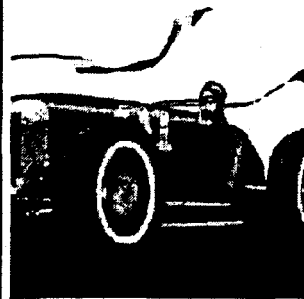
It's also true that the key asset for a CLEC, as for any other all-distance carrier, is a paying customer. Once that customer is obtained, with an anchor service of almost any type, the service provider stands positioned to sell additional services to the same customer. That's advantageous because it reduces customer acquisition costs and boosts margins, since multiple services often can be delivered over a single pipe. Indeed, that's the idea behind most CLEC-related mergers and acquisitions: Create a service bundle and sell that bundle using a single sales force, equipped with a broad product line.

Intermedia Communications Product Line Operating Margin, in Percent	
Enhanced Data Services	"Mid 30s, headed to 40 or more"
Internet Access and Hosting	50 to 60
Local Resale	"Negative to low"
Long Distance	mid 20s
Shared Tenant Services	Almost 50
Premises Equipment	Low 30s
Source: Intermedia Communications Inc.	

Still, few CLECs so far have gotten very far down that line. US LEC LLC, for example, "is just beginning to offer long distance service," says Tansukh Ganatra, US LEC chief operating officer. So only about 2 percent of gross revenues come from toll services. One problem, Ganatra notes, is that customers frequently have long-term contracts in place, so US LEC has to wait for agreement expiration before it can switch a customer.

But tactical reasoning also drives CLECs to offer long distance and data services, especially Internet access. A key factor in account profitability is the length of time any single firm remains a carrier's customer. And, as carriers in any number of markets have discovered, customer churn is reduced dramatically whenever any single customer buys two or more services from any single provider.

That's a key reason why cable TV operators offer telephony in the United Kingdom, why America Online Inc. sells long distance, and why AT&T Corp. attempts to sell Internet, local or wireless services into its existing customer base. Bundling reduces churn.



ICG Communications Inc.'s Netcom division, for example, which offers Internet access and hosting services, experiences high customer churn, like most of its peers.

"Netcom churns 2 percent to 6 percent of its customer base per month," notes company CEO Shelby Bryan. "And the bulk of the churn happens in the first 90 days."

So ICG looks to its bundled product--featuring local, long distance and Internet access--as a "killer" product for its small business customers. As it moves more traffic over to its own facilities, margins get a big lift. And there are real economies when all the services are delivered over a single T1 line.

Customer demand is an important factor as well. Smaller businesses "want local and long distance on one invoice, from one provider," says David Ruberg, CEO and chairman for Intermedia Communications Inc. "And data customers want more services delivered over one pipe." So Intermedia's watchword is, "Never sell local without long distance."

"Almost all our local service customers take our long distance as well," Ruberg says.

CLEC Acquisition Multiples

CLEC	Multiple of Gross Plant	Valuation Factor
WorldCom Inc.-MFS Communications Inc.	8.8	Global, integrated services
AT&T Corp.-Teleport Communications Group Inc.	6.6	National focus, integrated services, limited data
WorldCom-Brooks Fiber Properties Inc.	5.2	Regional, Tier-2 cities
Teleport Communications Group Inc. (TCG)-Eastern Telelogic Corp.	3.4	Single Tier-1 city
Brooks Fiber-Phoenix Fiber	3.0	Tier-3 cities
Brooks Fiber-Metro Access	2.6	Regional, CAP only
TCG-Kansas City Fiber Network L.P.	2.5	Single Tier-2 City, CAP only

Source: Bear, Stearns & Co. Inc.

McLeodUSA Inc., whose typical customer buys five to six access lines, finds that 95 percent of customers buy both local and long distance, says Blake Fisher, chief financial officer (CFO).

Sheer economics underscore the importance of long distance and other revenue sources. Whether a CLEC uses its own facilities or resells access, the simple fact remains that most medium-sized businesses are connected over T1 facilities that are not filled on a constant basis.

That means a CLEC can leverage an existing cost--the T1 connection--by driving more services over the single pipe. Adding Internet access, frame relay or long distance over the local services pipe improves the efficiency of any in-service facilities by generating multiple revenue streams.

So many CLECs who historically have not focused on the bundled approach can look forward to lots of financial upside as they roll out long distance services. So far, for example, only about 10 percent of customers have bought two or more services from the company, says Jack Reich, CEO for e.spire Communications Inc.

CLECs also can use long distance revenue and customer bases to balance near-term cash flow needs with long-term strategy. Local service resale, for example, "is proving to be an uneconomic solution," says Michael Ma, analyst for Deutsche Bank AG.

In a local resale environment "our margins are negative to bad," notes Rob Manning, Intermedia CFO.

Margins are slim, especially when a CLEC is offering local access

using resold incumbent facilities. So adding long distance, even at unexciting margins, meaningfully improves the revenue generated by each line. "We generally earn about \$50 a month, per line, in local access revenue," Reich says. "As long distance rolls out, that goes to \$80 a month."

Indeed, Reich expects that revenue per line will reach the \$85 to \$90 a month level as long distance is offered in all markets. The other important factor is that, as traffic is shifted from resold lines to on-network facilities, margin jumps to the "upper 30s or possibly 40s," Reich says.

In fact, the drive to acquire a wider geographic footprint and additional product lines may be factors driving a wave of CLEC mergers and acquisitions over the next year or so, say analysts at Bear, Stearns. Up to this point, many CLECs have acquired other CLECs to broaden their reach into new services and new geographies. Such "horizontal consolidation" will be driven by this fact: To be a long-term success in an industry as competitive as telecom, players either must focus on a specific niche (product, service or geography) or attempt to become large-scale companies that can offer full suites of telecom and data services to business customers nationwide, says Bear, Stearns' Henry.

In recent days, for example, acquisition multiples have gone to those companies that have truly national or even global network reach, a presence in the larger Tier-1 markets and full-service product portfolios that include data and Internet in addition to the core local and long distance voice skill sets, Henry notes.

Carriers that offer all these attributes have commanded premium multiples, while smaller-scale companies have been acquired at substantially lower multiples. So "it clearly seems to make sense for smaller CLECs to 'bulk up' in order to become better-positioned businesses and more attractive as acquisition candidates," Henry says.

For some CLECs, such as GST, long haul also is a revenue-generation tool. With a Pacific Rim orientation and key operations in California, GST wants to capitalize on the fact that "60 percent of California's long distance traffic is intrastate," says Joseph Basile Jr., president, chief operating officer and acting CEO. "About 40 percent of worldwide Internet traffic also originates or terminates in the state."

Owning its own facilities, including a recently activated 500-mile network linking Los Angeles and the San Francisco Bay area, allows the company higher margins on a huge amount of traffic moving back and forth between Northern and Southern California.

But the network also supports operations, since GST believes in connecting all its regional networks throughout the western United

States. Better cost control and support for high-bandwidth packet network services are key advantages. For example, GST is building a "converged network" using a combination of packet, frame and cell technologies across its existing western city rings and long-haul fiber routes in Arizona, California, Hawaii, Idaho, New Mexico, Oregon, Texas and Washington. Consolidating all types of traffic over that single network will reduce operating costs, according to Kevin Wright, chief technology officer.



Image: CLEC Acquisition Multiples

That's the same sort of thinking that drove Electric Lightwave Inc. to buy capacity from Qwest Communications International Inc. Though a regional CLEC focused on the western United States, Electric Lightwave needs "landing rights" on the East Coast and in Midwestern markets if it is to pursue data transport and Internet services opportunities aggressively.

NextLink Communications Inc.'s agreement to buy 24 fibers, a whole conduit and rights to additional capacity on future Qwest conduits, is driven by the same sort of calculus. Packet-based services, especially as used by larger businesses, inherently require continent-wide connections. Indeed, the largest accounts require global connections.

NextLink initially has emphasized local access lines, though it always has believed that "data and high-bandwidth services were the future," says Wayne Perry, CEO. "We'll build out higher-bandwidth services underneath our access line growth."

In Canada, MetroNet Communications Corp. likewise is activating a nationwide asynchronous transfer mode (ATM) network, and for many of the same reasons. Companies use packet networks to connect disparate company sites and branch offices, so no truly useful service can be limited to local connections.

Indeed, infrastructure to support packet networks and customers, who typically require connections all over the major population centers domestically, is a key factor driving many CLECs to build long-haul capacity. Intermedia, for example, resells frame relay network connectivity to regional Bell operating companies (RBOCs) US WEST Inc. and Ameritech Corp. And that capability is "our most distinguishing product offering," Ruberg says.



Image: U.S. and Intermedia Communications Addressable Markets

Intermedia's long-haul network supports frame relay access nodes in 4,320 cities, and provides the foundation for Intermedia's "managed services" initiative. Those provide outsourcing services.

Still, even for companies with strong enhanced data strategies, long distance revenue will continue to represent a larger revenue stream, simply because the data market is in its formative stages, while long distance represents a huge installed base of customers. Indeed, of the roughly \$200 billion that U.S. telecom carriers earn each year, only about \$3 billion is attributable directly to data services.

In the Canadian business and government market, which represents about \$10 billion in annual spending, local services represent \$5 billion, while long distance represents another \$5 billion, according to executives at Metronet Communications. Buried within those numbers are private line and data services, at \$211 million.

Though the U.S. CLEC industry ultimately stands or falls on its ability to capture switched local services market share, long distance remains an important tactical and strategic product offering for nearly all carriers, competitive or incumbent.

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